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AGENDA ITEM 9

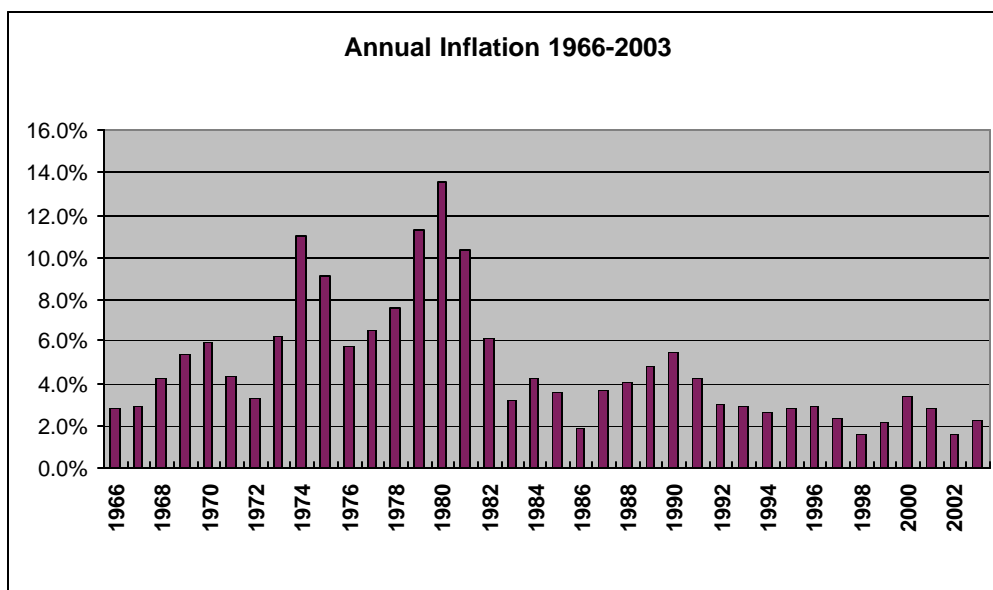
**TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION
COMMITTEE**

- I. SUBJECT:** Modification to the Assumed Annual Rate of Inflation
Used in Actuarial Valuations
- II. PROGRAM:** Actuarial & Employer Services
- III. RECOMMENDATION:** That the Committee accepts and recommends to
the full Board that the assumed annual rate of
inflation used in actuarial valuations be lowered from
3.5% down to 3.0%.
- IV. ANALYSIS:**

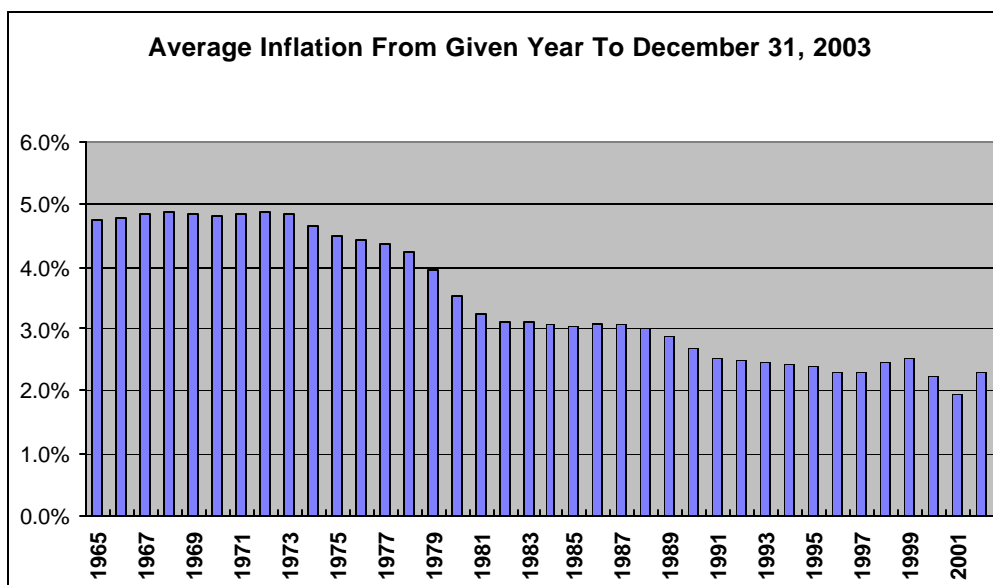
When performing actuarial valuations, actuaries use various demographic and economic assumptions to set a contribution schedule of employee contributions and employer contributions (called normal costs) which are designed to accumulate with interest to equal the total present value of benefits by the time every member has left employment.

One of the economic assumptions used is the annual rate of inflation. The assumed annual rate of inflation impacts various economic assumptions. It impacts the assumed investment return, the individual salary increases, the assumed payroll growth as well as the assumed cost-of-living increases (including Purchasing Power Protection Amounts – PPPA) for all current and future retirees.

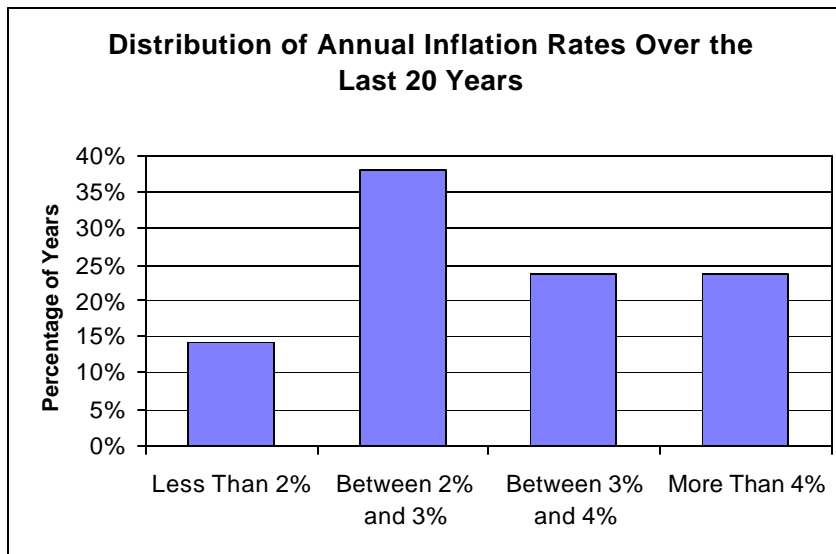
Below is a graph showing the annual inflation rates since 1965.



The current Board approved assumption for annual inflation is 3.5%. We believe that an assumed rate of inflation of 3.5% going forward is too high. As can be seen on the graph below, over the last 20 years, the average inflation has been at or below 3%.



To further demonstrate the need to lower the assumed annual inflation rate, below is another graph showing the distribution of inflation rates over the last 20 years. As can be seen on the graph, the annual inflation rate has been less than 3% more than 50% of the time over the last 20 years.



V. STRATEGIC PLAN:

This item is not a specific product of the Strategic or Annual Plans but is part of the regular and ongoing workload of the Actuarial & Employer Services Division.

VI. RESULTS/COSTS:

Changing the assumed annual inflation rate alone would cause an increase in cost for all employers. However, the change in assumed inflation rate is part of the experience study that CalPERS actuarial staff is currently finalizing. The results of the experience study will be presented to this Committee in May along with a recommendation for the adoption of new demographic assumptions. The cost impact on employer rates of all changes including demographic and economic assumptions will be brought forward as results are developed.

David Lamoureux, Senior Pension Actuary
Actuarial & Employer Services Division

Ron Seeling, Chief Actuary
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